



March 26, 2007

Mr. Winston Hickox
Chair, Cal EPA Market Advisory Committee
Via Email: climatechange@calepa.ca.gov

Re: Suggestions for the Market Advisory Committee

Dear Chairman Hickox,

On behalf of the Natural Resources Defense Council (NRDC), thank you and all of the Market Advisory Committee (MAC) experts for your efforts to assist California in implementing Assembly Bill (AB) 32. We offer the following comments on the MAC's activities.

At the MAC meeting on February 27th, we appreciated Secretary Adams and Vice Chair Goulder's reiteration that the MAC will not (and can not) make any decisions for California, and that instead it will serve in a purely advisory capacity. As a co-sponsor of Assembly Bill (AB) 32, NRDC believes that it is very important that the state follow the public process outlined in the bill for the California Air Resources Board (CARB) to determine *whether* AB 32 implementation will include market mechanisms, and *if so*, how they can best be designed to meet the law's goals. This must include, at a minimum, meeting the requirements of Health and Safety Code Section 38570 and providing opportunities for the Environmental Justice Advisory Committee and all stakeholders to provide input.¹

We believe the experts on the MAC can provide California's policymakers and stakeholders with valuable information as CARB's public process begins. We urge the MAC to focus its efforts on providing information about how market mechanisms work, the pros and cons of market mechanisms and various design elements, what lessons California can learn from past experiences around the world,² and what types of

¹ Health and Safety Code Section 38570(b) requires that CARB do all of the following before including a market-based compliance mechanism in its regulations: "(1) Consider the potential for direct, indirect, and cumulative emission impacts from these mechanisms, including localized impacts in communities that are already adversely impacted by air pollution. (2) Design any market-based compliance mechanism to prevent any increase in the emissions of toxic air contaminants or criteria air pollutants. (3) Maximize additional environmental and economic benefits for California, as appropriate."

² The MAC should also explore the differences that affect mechanisms to limit greenhouse gases and past mechanisms that have been used to address criteria pollutants. For example, there is no present "end of

analyses CARB should undertake to inform the decisions it will make. It will take time for CARB to conduct its needed analysis of market mechanisms, so it makes sense for CARB, other policymakers, and stakeholders to start studying market mechanisms now, even though pursuant to AB 32, those mechanisms can not be implemented until after early action measures and until CARB decides whether they should be included in the overall regulatory structure to reduce emissions that will become effective no sooner than 2012.

California will need to utilize multiple policy tools to meet the aggressive statewide emission limit established in AB 32.

NRDC supports the use of a *package* of policy tools, including first early action measures, and then both regulatory and market-based approaches, to meet the 2020 statewide emissions limit. Every type of policy tool has pros and cons; by combining them into a package we can maximize the benefits and minimize the downsides of using them individually. Existing and proposed regulatory programs such as the state's energy efficiency standards and programs, the renewable portfolio standard, and the low-carbon fuel standard help drive technological innovation, and reduce emissions relative to business as usual. These should be the foundation of the state's AB 32 implementation package.

To complement these regulatory programs, NRDC also supports a well-designed program that creates an enforceable absolute cap on emissions from certain sectors (that declines over time) and allows covered entities to use certain types of market mechanisms to demonstrate compliance. (This type of program is commonly known as a "cap and trade" program, although trading may be minimal if allowances are auctioned.) While AB 32 establishes a statewide emission limit that the state *itself* commits to achieve through a combination of implementing policies, a "cap and trade" program creates an enforceable limit on *emitters*; this can push emissions lower than can be achieved through the regulatory programs,³ and can stimulate innovation by providing companies with an incentive to exceed minimum requirements.

Meeting AB 32's statewide emissions limits is not a question of using either regulatory programs or market mechanisms – the state needs both. Indeed, California cannot have a market for emission allowances unless CARB adopts by regulation mandatory emission caps on sectors, and allows regulated entities to use market mechanisms for compliance. AB 32 recognizes this clearly by using the term "market-based *compliance* mechanism." (emphasis added) It is important to distinguish this type of market-based compliance mechanism from the existing voluntary "offsets" market, which many people may be familiar with. If CARB decides to adopt a "cap and trade" program,

stack" technology that can reduce carbon dioxide emissions – the state's primary greenhouse gas – whereas there are such technologies for sulfur oxides and nitrogen oxides.

³ It is important to note that most regulatory programs, such as the renewable portfolio standard, are intensity based, so that absolute emission levels may continue to rise even while the program reduces emissions relative to business as usual levels. To meet AB 32's limit, California must limit absolute emissions.

regulated entities will only be able to use those market mechanisms for compliance that have been approved by CARB.

A “cap and trade” program must be carefully designed to meet the state’s objectives.

NRDC will only support a “cap and trade” program that is well-designed, and that will enable the state to achieve deeper emission reductions while meeting the other policy goals outlined in the law. Clearly, the “devil is in the details” when it comes to designing a program that will maximize benefits for California. We urge the MAC to assist policymakers and stakeholders in understanding the key design details and considerations that merit the most attention to ensure success.

While there are numerous types of market mechanisms (including taxes, incentives, etc.), NRDC supports the MAC’s decision to focus its efforts on exploring the “cap and trade” approach. Given the limited timeframe for the MAC’s activities,⁴ we believe it will be more useful for the committee to provide in-depth insights into one type of mechanism rather than high level information about many. And we think the focus on a cap and trade program makes sense because California has less experience with this particular type of mechanism than most of the other strategies, and it holds significant promise because it provides for an absolute enforceable cap on emissions from key sectors.

We urge the MAC to begin by defining the terminology it is using and to encourage all stakeholders to be clear in the terminology they use. We have found that many stakeholders currently use key terms to mean dramatically different things; for example, we use the term “trading” in a narrow sense to mean a mechanism authorized by the regulator allowing entities in sectors with mandatory enforceable caps to use allowances purchased from other entities in capped sectors for compliance, while others use the term to denote the use of emission reductions from projects in sectors that are not capped (also known as “offsets”), and still others use it to mean the existing voluntary offsets market. Clarifying the terminology will enable stakeholders to meaningfully discuss the pros and cons of various design elements.

We further urge the MAC to share their insights on what factors CARB should consider in deciding key design details, including (i) what sectors should have enforceable emission caps, (ii) how to ensure that the level of the cap is set appropriately tight, and declines appropriately over time, (iii) how to distribute allowances, (iv) what types of market mechanisms and flexible compliance mechanisms should be allowed,⁵ (v) how to design the program to complement the state’s air quality improvement and toxic pollution reduction goals, and (vi) how to design effective enforcement mechanisms.

⁴ Executive Order S-20-06 calls for the Market Advisory Committee to make recommendations to CARB on or before June 30, 2007.

⁵ There has also been considerable discussion about the possibility of linking California’s system to other states’ and countries’ systems. We urge the MAC to explore what linking is (e.g., linking can only occur if CARB allows regulated entities to use allowances issued by other jurisdictions for compliance) and what criteria CARB would need to consider before deciding whether to allow linking with particular jurisdictions (e.g., comparably stringent caps, comparable mandatory reporting, strong enforcement, etc.).

Thank you for considering our input as the MAC begins its process. We appreciate the time and effort each of the MAC members is contributing to help California successfully implement AB 32.

Sincerely,

A handwritten signature in black ink, appearing to read "Devra Wang", with a stylized flourish at the end.

Devra Wang
Director, California Energy Program

cc: Brian Prusnek, Deputy Cabinet Secretary
Linda Adams, Secretary for Environmental Protection
Dan Skopec, Undersecretary, California Environmental Protection Agency
Anne Baker, Deputy Secretary for External Affairs, California Environmental Protection Agency
Eileen Tutt, Assistant Secretary for Climate Change Initiative, California Environmental Protection Agency
Dr. Robert Sawyer, Chairman, CARB
Catherine Witherspoon, Executive Officer, CARB
Chuck Shulock, Program Manager for GHG Reduction, CARB